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IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. 731

NATIONAL LEAD COMPANY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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November 30, 1964.

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INDEX

	Page
Opinions Below	1
Jurisdiction	2
Questions Presented	2
Statutes Involved	3
Statement	4
Why the Writ Should Be Granted	
Importance of Question	6
Policy of Repose	8
Duality of Jurisdiction	12
Conclusion	13
Appendix A	1a

CITATIONS

CASES:

Higgins v. *Smith*, 308 U.S. 473 (1940) 7, 8
Rothensies v. *Electric Storage Battery Co.*, 329 U.S. 296 (1946) 9, 10, 11

STATUTES:

Internal Revenue Code of 1939

Section 22(a)	3
Section 23(f)	3
Section 131	13
Section 131(a)(1)	3
Section 131(b)(1)	4
Section 131(f)	13
Title 28, U.S.C., Sec. 1254(1)	2

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The petitioner, National Lead Company, petitioner below, prays that a writ of *certiorari* issue to review the judgment of the Court of Appeals for the Second Circuit in the above-entitled case.

OPINIONS BELOW

The findings of fact and opinion of the Tax Court are reported at 40 T.C. 282. The opinion of the Court of Appeals for the Second Circuit is reported at 336 F. 2d 134, and the pertinent portion thereof is printed herein as Appendix A.

JURISDICTION

The judgment of the Court of Appeals for the Second Circuit, affirming the decision of the Tax Court in respect of the issues to which this petition is addressed, was entered September 1, 1964. The jurisdiction of this Court is invoked under Title 28, U.S.C., Sec. 1254(1).

QUESTIONS PRESENTED

The fundamental question presented, from which three subsidiary questions stem, is whether a sale of certain corporate shares, made by the petitioner in 1937 to its wholly-owned British subsidiary, in order (for all that appears) to establish a tax loss, must be treated, in open tax years subsequent to 1937, as never having been made at all. The subsidiary questions, and ultimate questions in terms of tax result, are:

(a) Whether the petitioner is entitled to deduct as an ordinary loss, the difference, arising out of British currency devaluation, between the dollar value when incurred in 1937, and the dollar value when repaid in 1952, of an indebtedness due it from its wholly-owned British subsidiary, in respect of the aforesaid sale of corporate shares.

(b) Whether the petitioner is required to include in its own gross income, in open tax years subsequent to 1937, dividends received by its wholly-owned British subsidiary in respect of the aforesaid corporate shares.

(c) Whether the petitioner is required to include in its own gross income, in open years subsequent to 1937, gains derived by its wholly-owned British subsidiary upon the sale by the subsidiary of some of the aforesaid corporate shares.

STATUTES INVOLVED

This case does not involve any construction of the language of statute or regulation. However, the provisions below are quoted, for reference, as those under which items of income are commanded to be included for tax; items of deduction are allowed; and permissible foreign tax credits are specified.

Internal Revenue Code of 1939, as amended:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from * * * dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from * * * dividends * * *, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

SEC. 23. DEDUCTIONS FROM GROSS INCOME.
In computing net income, there shall be allowed as deductions:

* * *

(f) *Losses By Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

SEC. 131. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

(a) *Allowance of Credit.*—If the taxpayer chooses to have the benefits of this section, the tax imposed by this chapter * * * shall be credited with:

(1) Citizens and Domestic Corporations.—In the case of a citizen of the United States and of a domestic corporation, the amount of any income, war-profits, and excess-profits paid or accrued during the taxable year to any foreign country * * *.

* * *

(b) *Taxes of Foreign Corporation.*—

(1) Treatment of Taxes Paid By Foreign Corporation.—For the purposes of this section, a domestic corporation which owns at least 10 per centum of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of any income, war-profits, or excess-profits taxes paid or deemed to be paid by such foreign corporation to any foreign country * * * upon or with respect to the accumulated profits of such foreign corporation from which such dividends were paid, which the amount of such dividends bears to the amount of such accumulated profits. * * *

STATEMENT

The material facts are as follows:

In December, 1937, the petitioner caused its wholly-owned British subsidiary, Hoyt Metal Co. of Great Britain, Ltd. ("Hoyt Metal") to purchase from it a block of shares of Goodlass Wall and Lead Industries, Ltd. ("Goodlass Wall"), another British corporation. Those shares had cost the petitioner $1,677,970 and when sold were worth $1,288,939, at prevailing London Stock Exchange prices. The difference of $389,031 was treated by the petitioner as a deductible capital loss, which it offset against certain other gains which it had derived in the same year, 1937.

Hoyt Metal did not make immediate payment in cash for the Goodlass Wall stock it acquired. Instead, both petitioner and Hoyt Metal treated the amount due, some £257,884, as an indebtedness, on open account. Hoyt Metal also owed the petitioner certain other amounts, for a total of some £279,867. In 1938, 1939,

and 1940, Hoyt Metal reduced its debt to some £229,063. Except for a small adjustment, no further payments were made until 1952.

In the course of the 14 years after 1937, which embraced, of course, World War II and its difficult aftermath, Hoyt Metal had modest earnings. These were augmented by dividends received on Goodlass Wall shares, which Hoyt Metal retained for itself. On occasion, Hoyt Metal sold certain of the Goodlass Wall shares, and retained the proceeds for itself.

In 1952, the petitioner needed certain foreign exchange, specifically Deutschemarks, for its own corporate purposes. It met its needs by purchasing, on its own credit, British government bonds in the amount of some £228,613, the amount at which Hoyt Metal's indebtedness then stood. The petitioner promptly exchanged those bonds for Deutschemarks, and then caused Hoyt Metal to sell sufficient Goodlass Wall shares to enable Hoyt Metal to liquidate its indebtedness to the petitioner, which it did by remitting for the petitioner's account to the bank which had financed the petitioner's purchase of the British bonds.

When Hoyt Metal originally incurred its indebtedness in 1937, the pound sterling was worth nearly $5.00. When the debt was finally liquidated in 1952, the pound had been devalued, and stood at about $2.60. As a result, the petitioner received, in dollar value, considerably less than it would have received had the debt been paid with $5.00 pounds. The difference, some $568,755, the petitioner treated as a fully deductible foreign exchange loss in its tax return for 1952.

The Commissioner of Internal Revenue refused to allow the petitioner's claimed foreign exchange loss.

The Tax Court upheld the Commissioner, and its decision in this respect was affirmed by the Court of Appeals.

The Commissioner went further, however, and treated as dividends received directly by the petitioner, those paid by Goodlass Wall to Hoyt Metal. Additionally, the Commissioner treated as gains derived by the petitioner itself, those which Hoyt Metal received and retained from sales of Goodlass Wall shares. Here, too, the Tax Court upheld the Commissioner, and the Court of Appeals affirmed.

WHY THE WRIT SHOULD BE GRANTED

The writ should be granted because the Court of Appeals for the Second Circuit has decided an important question of Federal law which has not been, but should be, settled by this Court.

Importance of Question

The opening paragraph of Judge Marshall's opinion below, relevant to the issues as to which a writ of certiorari is sought by this petition, is as follows:

> The second and third issues in this case present interesting variations of a single theme: what consequences flow from the sale of property to a wholly-owned subsidiary, the loss on which sale is not deductible under the rule of *Higgins* v. *Smith*, 308 U.S. 473 (1940); *Crown Cork International Co.*, 4 T.C. 19 (1944), aff'd, 149 F. 2d 968 (C.A. 3, 1945); and *Bank of America N.T. & S.A.*, 15 T.C. 544 (1950), aff'd, 193 F. 2d 178 (C.A. 9, 1951). This question has, to our knowledge, not been presented to an appellate court heretofore.

As Judge Marshall says, the question here presented has not been before any other appellate court. Apart from its novelty, we submit that the question is of

sufficient importance to warrant this Court exercising its discretion to grant the writ (Rule 19).

The courts below have made a far-reaching and unwarranted extension of the principle of *Higgins* v. *Smith, supra.* Judge Atkins of the Tax Court said, in his opinion, expressing the ultimate basis for the Tax Court decision:

> * * *We think that the principle of *Higgins* v. *Smith, supra,* requires the conclusion that the transfer is to be disregarded or dismissed from consideration for *all* purposes of application of the taxing statute. (p. 303, Court's emphasis)

The Court of Appeals did not adopt Judge Atkins' language *in haec verba*, but its conclusions come to the same end.

In 1937, the petitioner sold certain shares of a British corporation to its wholly-owned British subsidiary, and claimed a "tax loss". That loss was allowed for 1937, though perhaps the principle of *Higgins* v. *Smith* (decided in 1940) would have been relevant. On the theory that *Higgins* v. *Smith* requires that the parties to a tax loss sale be regarded as never having entered into the transaction at all, the courts below held that:

> I. The petitioner is not entitled to a deduction for a loss, claimed for 1952, resulting from the fact that when the subsidiary finally liquidated the debt incurred in purchasing the shares in question, the British pound sterling had been devalued.
>
> II. The petitioner must include in its gross income for 1952 dividends received in that year by the subsidiary upon the shares in question, and gains from the sale by the subsidiary of some of the shares.

That this extension of the principle of *Higgins* v. *Smith* is far reaching is readily demonstrable. Until that case was decided, in 1940, tax loss sales to controlled entities were common enough. No doubt they began in 1909, in the case of corporations, and in 1913 in the case of other taxpayers. This means that if the Commissioner's agents can ferret out such a sale in *any* year since 1909, no matter how long the year has been otherwise closed, he can wreak havoc on long-established and bona fide relationships, by arbitrarily attributing ownership, and the tax consequences of ownership, to non-owners, in any open year, current or future.

The petitioner cannot, of course, prove statistically that, in due course, a large number of cases involving similar extensions of the principle of *Higgins* v. *Smith* will come before the courts. Yet, as is well-known, the ingenuity and energy of the Commissioner's agents and attorneys is productive—as it should be—of many issues and controversies, and it is hardly to be expected that they will not use the decisions below as tools of their trade. However, it would seem to be of substantial importance that they, and the lower courts concerned, should be instructed as to the true reach of *Higgins* v. *Smith*.

Policy of Repose

What has been said will at least suggest the basic juridical reason for review of this case: the principle or policy of repose. Ultimately, the time for controversy, for review, for revival of record and memory, must end, else the judiciary and the administrative machinery of the Government, and the citizens whom they serve, can ultimately be sorely pressed.

There is in this case no question but that when the controversy in this case arose, the statute of limitations with respect to 1952, the specific tax year involved, had not expired. Thus the petitioner cannot maintain that the Commissioner slept on his rights, as to 1952. Yet, it is in a sense shocking that the holdings below, in effect if not in full substance, rely upon a "reopening" of the tax year 1937, fifteen years prior to that directly involved, as to which the statute of limitations had long since expired.

We reiterate that as to 1952, the petitioner cannot urge a *statute* of limitations. We recognize, moreover, that *statutes* of limitation are creatures of the Congress. Yet, behind such statutes lies the *principle* of repose, which finds expression not only in Congressional enactments, but in decisions of this Court. We submit that the principle applies here.

In *Rothensies* v. *Electric Storage Battery Co.*, 329 U.S. 296 (1946), the taxpayer had paid certain excise taxes on electric storage batteries through and for the period April 1919 to April 1926. The statute of limitations for refunds for the April 1919 to April 1922 period expired before the taxpayer made a claim, but timely claims were filed for the April 1922 to April 1926 period.

In due course, in 1935, the 1922-1926 claims were allowed and refund was made. For the latter year, the Government claimed additional income taxes in respect of the refund. This claim was upheld, but the taxpayer countered with its own claim, for "recoupment" against the additional 1935 tax, the excise taxes overpaid for the 1919-1922 period. The lower courts held

for the taxpayer on this point. This Court reversed. The searching opinion by Mr. Justice Jackson included the following:

> This case represents an effort, thus far successful, to obtain advantage by way of recoupment of a claim for tax refund long since barred by the statute of limitations. The facts of *this singular situation* are not in dispute.
>
> * * *
>
> The gravity of this holding [by the lower courts] to the administration of the tax laws led us to grant certiorari. (pp. 298, 299, emphasis and brackets supplied)[1]

and further:

> It probably would be all but intolerable, at least Congress has regarded it as ill-advised, to have an income tax system under which there never would come a day of final settlement and which required both the taxpayer and the Government to stand ready forever and a day to produce vouchers, prove events, establish values and recall details of all that goes into an income tax contest. Hence, a statute of limitation is an almost indispensable element of fairness as well as of practical administration of an income tax policy.
>
> We have had recent occasion to point out the reason and the character of such limitation statutes. "Statutes of limitation, like the equitable doctrine of laches, in their conclusive effects are

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[1] The Court pointed out that each of the two cases chiefly relied upon below, *Bull* v. *U.S.*, 295 U.S. 247 (1935), and *Stone* v. *White*, 301 U.S. 532 (1937), involved a single transaction or taxable event which had been subjected to two taxes on inconsistent legal theories, and what was mistakenly paid was recouped against what was correctly due.

designed to promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared. The theory is that even if one has a just claim it is unjust not to put the adversary on notice to defend within the period of limitation and that the right to be free of stale claims in time comes to prevail over the right to prosecute them." *Order of R. Telegraphers* v. *Railway Express Agency*, 321 U.S. 342. "They are by definition arbitrary, and their operation does not discriminate between the just and the unjust claim, or the voidable and unavoidable delay. They have come into the law not through the judicial process but through legislation." *Chase Securities Corp.* v. *Donaldson*, 325 U.S. 304.

As statutes of limitation are applied in the field of taxation, the taxpayer sometimes gets advantages and at other times the Government gets them. Both hardships to the taxpayers and losses to the revenues may be pointed out.* * * * (pp. 301, 302)

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* In *American Light & Traction Co.* v. *Harrison*, (C.C.A. 7th, Ill.) 142 F. 2d 639 * * *, the court did not allow recoupment to the Government. But, judiciously, it said, "Although here a hardship on the Government results from the taxpayer's inconsistency, the correlative provisions of this same statute will, in the converse of the instant situation, work an equal hardship on the taxpayer." 142 F. 2d 639, 643. Whether or not the statute, §§ 608 and 609 of the Revenue Act of 1928, be taken to compel the conclusion we reach in this case, the court's recognition that both parties to taxation are affected impartially, though perhaps harshly, by policy of repose has application here. * * *

The sound principle of ultimate repose which the *Electric Storage Battery, supra*, case expresses, we respectfully submit, was violated by the decisions be-

low. Those decisions do not accord with "the element of fairness" which is indispensable to practical administration of the tax laws. Perhaps, on its face, it does not seem unreasonable to some to ask a taxpayer to justify or explain what took place 15 years before the tax year in question, but much can be forgotten and lost in 15 years. The administrative necessity for review after 15 years and more have passed is, absent fraud, by no means obvious, and the simple justice of it even less so.

Duality of Jurisdiction

The property which was sold in this case consisted of shares of a British corporation; and the shares were sold to a British corporation. For many years the property sold, and the purchaser, were subject to British corporate law, to British property law, to British tax law, and to British foreign exchange law, and the like.

While the petitioner here would be unwilling to contend that a rule of law applicable to a British subsidiary of an American concern should be in any essential different from that applicable to an American subsidiary, we still wish to point out, as accentuating the incorrectness, impracticality, and injustice of the holdings below, the following:

(I) The loss claimed by the petitioner for the tax year 1952 was not attributable to the petitioner's action; it was not contrived; it was due solely and only to the devaluation of the pound sterling by the British

government, which, surely, was not "dominated and controlled" by the petitioner or its subsidiary.[2]

(II) Taxation directly to the petitioner of British dividends received and gains derived by its British subsidiary are not to be lightly dismissed by adverting to United States credits for foreign taxes. The subject of such credits for foreign taxes is intricate and complex, as a mere glance at section 131 of the Internal Revenue Code of 1939, which would apply to 1952, will demonstrate. There are many limitations. For example, no domestic corporation, such as the petitioner here, can have the benefit of the credit for taxes "deemed to have been paid", under section 131 (f) in respect of dividends paid by a British corporation unless the domestic corporation owns at least 10 per cent of the voting stock of the British corporation. Whenever the petitioner's "ownership" of Goodlass Wall voting shares drops below 10%, the petitioner is bound to be taxed by both the United Kingdom and the United States. The decisions below sanction such double taxation and thus, we submit, are plainly wrong.

CONCLUSION

The Court of Appeals for the Second Circuit has decided, erroneously, as the petitioner proposes to show, an important question of Federal law which has not been, but should be, settled by this Court.

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[2] Would the Commissioner concede that if devaluation had been by the United States, as in 1934, there would have been no "gain" in 1952, because "no debt existed"? Or is sauce for the goose not sauce for the gander, if the gander so chooses?

This petition for a writ of *certiorari* should be granted.

Respectfully submitted,

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November 30, 1964.

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 410—September Term, 1963.

(Argued May 14, 1964 Decided September 1, 1964.)

Docket No. 28586

NATIONAL LEAD COMPANY, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

Before: KAUFMAN, HAYS and MARSHALL, *Circuit Judges.*

Petition to review a decision of the Tax Court, 40 T. C. 282, sustaining a deficiency in petitioner's income tax for the year 1952. Affirmed in part and reversed in part.

KARL RIEMER, Washington, D. C. (Pehle, Mann, Riemer & Luxford, Washington, D. C. of counsel), *for Petitioner.*

KARL SCHMEIDLER, Attorney, Dept. of Justice, Washington, D. C. (Louis F. Oberdorfer, Asst. Attorney General, Lee A. Jackson, Harry Baum, attorneys, Dept. of Justice, Washington, D. C. on the brief), *for Respondent.*

MARSHALL, *Circuit Judge:*

This petition for review of the Tax Court presents three issues relating to petitioner's income tax liability for the

year 1952. The first is whether it validly revoked an election to use the "LIFO" inventory replacement provisions of section 22(d)(6)(F) of the Internal Revenue Code of 1939; the second is whether it may deduct as a loss the repayment by a British subsidiary of an outstanding debt which arose out of petitioner's sale of stock to the subsidiary in 1937, where the subsidiary repaid in devalued British currency; the third is whether petitioner is taxable on dividends received by the subsidiary on the transferred stock and on the gain realized by the subsidiary when it sold some of the stock.

* * * * * * * * * *

II. The "Hoyt Metal" Issues

The second and third issues in this case present interesting variations of a single theme: what consequences flow from the sale of property to a wholly-owned subsidiary, the loss on which sale is not deductible under the rule of *Higgins* v. *Smith*, 308 U.S. 473 (1940); *Crown Cork Int'l Co.*, 4 T. C. 19 (1944), *aff'd*, 149 F. 2d 968 (3 Cir. 1945); and *Bank of America N. T. & S. A.*, 15 T. C. 544, *aff'd*, 193 F. 2d 178 (9 Cir. 1951). This question has, to our knowledge, not been presented to an appellate court heretofore.

Briefly stated, in 1937 the petitioner sold certain shares of the Goodlass Wall and Lead Industries, Ltd., a British corporation, to its wholly-owned subsidiary, a British corporation named Hoyt Metal Co. of Great Britain, Ltd. The sale was made at petitioner's instance and request, and primarily was intended to secure a capital loss for that year, which would offset capital gains on the sales of other stock. The sale price was the current market value of the Goodlass shares on the London Stock Exchange, and amounted to £257,884 11s., which at the prevailing rate of exchange in 1937 equalled $1,288,938.56. Hoyt set up the purchase price on its books as a sterling debt to petitioner, while petitioner set it up on its books as an account

receivable of $1,288,938.56. At the time, Hoyt had resources in no way sufficient to make payment for shares. The petitioner claimed a loss of $389,031.19 on its 1937 tax return, a figure which the Commissioner allowed. It is not disputed that, under the cases cited above, such deduction would have been disallowed had the Commissioner taken action.

During the next fourteen years, Hoyt held the stock in its own portfolio and received substantial dividends from Goodlass. During most of those years, Hoyt declared and paid dividends to petitioner; the amount of these dividends bore no particular relationship to the dividends Hoyt received on the Goodlass shares. In the same period, Hoyt earned profits of between roughly £6,200 and £29,300 annually from its other operations. In addition to the debt arising out of the stock sale, Hoyt was also liable to petitioner for dividends declared but not paid in previous years, for a total indebtedness of £279,867-6-4. In 1938, 1939, and 1940, Hoyt reduced this debt by payments to £229,063-13-0. Except for an adjustment of a few hundred pounds, this figure remained unchanged through 1951. On December 31, 1951, the dollar debt on petitioner's books stood at $1,153,823.93.

During the year 1952, petitioner purchased for its own account, through the London office of the Guaranty Trust Co. of New York, British bonds in the sum of £228,612-17-9 —the exact amount of Hoyt's sterling indebtedness. In the same period, Hoyt sold on the London exchange 242,350 shares of Goodlass, for a total consideration of £228,707-3-10. It remitted nearly all of the proceeds (except for the difference of £94-6-1) to the Guaranty Trust Co. office, and as it did so, both it and petitioner gradually reduced the outstanding debt to the vanishing point. It is clear from the record that Hoyt Metals made these sales in order to afford its parent the sterling necessary to pay for the bonds. In other words, like the 1937 transaction,

the 1952 sale was at petitioner's instance and request, and in furtherance of its own corporate purposes.[1]

At the time of the 1952 transaction, the equivalent of the sterling debt was $585,068.29, owing to the devaluation of the pound. National Lead claimed the difference between this figure and $1,153,823.93, to wit, $568,755.64, as an ordinary loss. The Commissioner disallowed it on audit of the return.

At the same time, the Commissioner determined that National Lead realized gain on Hoyt's disposition of 40,000 shares of Goodlass stock which it sold on the open market in 1951, and on the disposition of the 243,350 shares of stock in 1952. The gain was figured by subtracting from the dollar equivalent of the sales price, the basis of the stock in petitioner's hands in 1937, less the amount taken as a deduction at that time and giving effect to a 2-1 stock split which Goodlass made in September 1951.[2] He also charged petitioner with the sum of $113,649.72 representing the 1952 dividend paid Hoyt by Goodlass. These adjustments were all made on the theory that, as the 1937 sale should be disregarded for tax purposes, ownership of the Goodlass stock never left petitioner and the corporate entity of Hoyt should be disregarded in connection with the Goodlass stock.

Petitioner's arguments in favor of its currency exchange deduction boil down to a contention that, whatever the merits of the 1937 transaction may be, it was at least effective to create a valid debt between itself and Hoyt, upon

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[1] After purchasing the British bonds, petitioner exchanged them for West German deutschemarks, which it used to enable another wholly-owned subsidiary to purchase full stock ownership of a German manufacturing concern.

[2] The gain on the 1951 sale is relevant to this proceeding only insofar as it reduces the capital loss carryover available to petitioner in 1952.

whose satisfaction in depreciated pounds a loss was sustained. It charges the Commissioner with attacking valid transactions for no other purposes than that they had a tax-inspired motive, and buttresses its argument with such taxpayer-favored cases as *Chisholm* v. *Commissioner,* 79 F. 2d 14 (2 Cir. 1935); *Loewi* v. *Ryan,* 229 F. 2d 627 (2 Cir. 1956); *Granite Trusi Co.* v. *United States,* 238 F. 2d 670 (1 Cir. 1956); and *Sun Properties Inc.* v. *United States,* 220 F. 2d 171 (5 Cir. 1955). At the same time, it does not challenge the Tax Court's basic assumption that, under *Higgins* v. *Smith, supra,* the 1937 transaction was vulnerable to attack even though the Commissioner forbore at the time.

Economically, of course, the taxpayer's argument is totally unjustified. In December 1937, it owned shares with a basis of $1,677,870. Disregarding the purported transfer, it disposed of about 29 percent of this stock in 1952, having a basis of about $485,000,[3] for a consideration of $505,490. The net effect, when the transactions in this portion of the Goodlass stock were realistically closed, was a profit, not a loss. Yet taxpayer not only has already recognized a loss of $389,000 in 1937, but it now seeks to have recognized another paper loss of nearly half a million dollars. This argument cannot be permitted to prevail. We think the record clearly sustains the Tax Court's conclusion that "the petitioner did, in fact, exercise substantial domination and control over the subsidiary with respect to the relationship between them in respect to the Goodlass stock."[4] Although the books of the companies reflected a debt outstanding between Hoyt and the petitioner from the 1937 transaction until the 1952 "repayment," it seems clear that, first, the original sale was at the sole instigation of the parent; second, that the subsidiary was in no position to satisfy the

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[3] This figure does not reflect the reduction in basis caused by the sale at a loss in 1937.

[4] 40 T.C. 282, 299 (1963).

1937 debt at the time of the sale or for a long period thereafter; third, that the account was allowed to remain dormant for a long period of time; and fourth, that the eventual "repayment" was done to facilitate the parent's financing of another transaction with third parties. It could thus properly be found, as the Tax Court did find, not only that there was no arm's length deal between the parties, but also that the transaction was not one that would be entered into by parties dealing at arm's length. Cf. *Nassau Lens Co.* v. *Commissioner*, 308 F. 2d 39, 45-46 (2 Cir. 1962).

On the surface, this case does not involve a loss deduction arising out of the sale of stock, but rather a currency exchange loss. However, petitioner would be entitled to this loss only if the debt owed to it by Hoyt is found to be valid and recognizable for tax purposes—or, in other words, if it is found to have economic substance. The mere fact that the initial transaction which gave rise to the debt was recognized in 1937 does not prevent the Commissioner from attacking its validity now.

We are convinced that *Higgins* v. *Smith*, *supra*, which would obviously bar recognition of the 1937 loss if that question were open, operates with equal force with respect to the 1952 transaction. The Court there observed that "there is not enough of substance in such a sale finally to determine a loss," 308 U.S. at 476, and that there was a "natural conclusion that transactions, which do not vary control or change the flow of economic benefits, are to be dismissed from consideration." *Ibid.* The inference to be drawn from this language is that such sales do not constitute a taxable event, and that the final computation of gain or loss must await the acquiring corporation's disposition of the shares transferred to it. There being no loss on the ultimate disposition of the Goodlass stock, no loss may be recognized for tax purposes now. To do so would compound the error originally made in 1937.

Whatever may be the merits of the general rule that the repayment of a debt is a separate event, taxwise, from the

transaction which gave rise to that debt, see *Elverson Corp.* v. *Helvering*, 122 F. 2d 295 (2 Cir. 1941); *Bingham* v. *Commissioner*, 105 F. 2d 971 (2 Cir. 1939); *Hale* v. *Helvering*, 85 F. 2d 819 (D. C. Cir. 1936); it has no application where the sale giving rise to the debt did not affect the creditor's economic position regarding the property.

For substantially the same reasons, we are also constrained to accept the Tax Court's holding that the dividends received by Hoyt on the Goodlass stock, and the gain it derived on the sales of Goodlass stock in 1951 and 1952, are properly allocable to the petitioner here. If the initial transfer lacked economic reality because of the transferor's continuing control over the property, we can see no basis for distinguishing these items from the one considered before. It is true that in *Commissioner* v. *Smith*, 136 F. 2d 556 (2 Cir. 1943) involving the same individual taxpayer and corporation as in *Higgins* v. *Smith*, *supra*, we stated that the Commissioner was to consolidate the individual and corporate accounts for the years in question, including the income of both and all their properly deductible expenses and losses. However, we later stated, in *O'Neill* v. *Commissioner*, 170 F. 2d 596 (2 Cir. 1948) that "Higgins v. Smith . . . and the subsequent cases in which wholly owned and controlled corporations have been disregarded in whole or in part for tax purposes did not require the Commissioner as a condition of his disregarding such a corporation for one tax purpose, to ignore it for all tax purposes." Since the separate existence of Hoyt is not challenged except with respect to the Goodlass stock, it would seem that proper recognition of this condition necessitates only allowing the foreign tax credit on the dividends Hoyt received from Goodlass, which the Commissioner has conceded. Petitioner does not seek any other adjustment of its tax liability in this connection.

The judgment of the Tax Court is reversed in part and affirmed in part, and judgment will be entered accordingly.

In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 731

NATIONAL LEAD COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The Tax Court's findings of fact and opinion (R. 85–118)[1] are reported at 40 T.C. 282. The opinion of the court of appeals (Pet. 1a–7a) is reported at 336 F. 2d 134.

JURISDICTION

The judgment of the court of appeals was entered on September 1, 1964. The petition for a writ of certiorari was filed on November 30, 1964. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

QUESTIONS PRESENTED

1. Whether an alleged sale of stock of a British corporation in 1937 from the taxpayer to its wholly owned

[1] Record references are to the petitioner's appendix in the court of appeals.

761-257—65

subsidiary lacked economic substance and should be disregarded for tax purposes, with the result that the taxpayer is not entitled to a currency loss deduction in 1952 allegedly incurred upon the receipt of depreciated British currency in purported settlement of the 1937 sales price.

2. If the alleged sale of the British stock in 1937 by the taxpayer to its subsidiary is not recognized for tax purposes, whether dividends paid in 1952 by the British corporation upon its stock to the taxpayer's subsidiary, and gain realized in 1951 and 1952 from the sale of the stock by the subsidiary to others, belong to the taxpayer and are includible in the taxpayer's income for those years.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.
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> (26 U.S.C. 1952 ed., Sec. 22)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

STATEMENT

In 1937 the taxpayer sold certain shares of the Goodlass Wall and Lead Industries, Ltd., a British corporation, to its wholly owned subsidiary, a British corporation named Hoyt Metal Company of Great Britain, Ltd. The sale was made at the taxpayer's instigation and was primarily intended to secure a capital loss to the taxpayer for that year which would offset capital gains on the sale of other stock. The sale price was the then current market value of the Goodlass shares on the London Stock Exchange and amounted to £257,884, which, at the 1937 prevailing rate of exchange, was $1,288,938.56. Hoyt set up the purchase price on its books as a sterling debt to the taxpayer, while the taxpayer treated it as a dollar account receivable. At the time Hoyt lacked sufficient resources to pay for the shares. The taxpayer claimed a loss on the sale on its 1937 tax return of $389,031.19, which the Commissioner allowed. It is not disputed that such a deduction would not have been allowed under current decisions. (Pet. 2a–3a.)

For the next fourteen years Hoyt held the stock in its own portfolio and received substantial dividends from Goodlass. During most of those years Hoyt declared and paid dividends to the taxpayer, although the amount of those dividends bore no particular relation to the dividends Hoyt received on the Goodlass shares. During the same period Hoyt's annual earnings varied between £6,200 and £29,300, and Hoyt made no substantial reduction in the debt. (Pet. 3a.)

During 1952 the taxpayer purchased for its own account in London British bonds in the sum of over £228,612—the remaining balance of Hoyt's sterling indebtedness to it. In the same period Hoyt sold on the London Exchange 243,350 shares of Goodlass stock (which comprised only part of the Goodlass shares held by it) for a total consideration of over £228,707 and remitted nearly all of the proceeds from the sale to the taxpayer's account in a London bank, thereby satisfying its outstanding debt to the taxpayer. Hoyt made these sales in order to afford its parent the sterling necessary to pay for the bonds. In other words, like the 1937 transaction, the 1952 sale was at the taxpayer's instigation and request and in furtherance of the taxpayer's own corporate purposes. After purchasing the British bonds the taxpayer exchanged them for West German Deutsche marks which it used to enable another wholly owned subsidiary to purchase full stock ownership of a German manufacturing concern. (Pet. 3a–4a.)

At the time of the 1952 transaction, the equivalent of the sterling debt was $585,068.29, by virtue of the devaluation of the pound. The taxpayer claimed the

difference between this figure and $1,153,823.93—*i.e.*, $568,755.64—as an ordinary loss. The Commissioner disallowed the claim. (Pet. 4a.)

At the same time, the Commissioner determined that the taxpayer realized gain in 1951 and 1952 on Hoyt's disposition on the open market of 283,350 additional shares of Goodlass stock. The Commissioner also charged the taxpayer with income from dividends paid in 1952 by Goodlass to Hoyt. These adjustments were made by the Commissioner on the theory that, as the 1937 transaction should be disregarded for tax purposes, ownership of the Goodlass stock never left the taxpayer. (Pet. 4a.) Finally, in 1956, Hoyt declared a dividend to the taxpayer of approximately £283,900 in purported payment of which it transferred to the taxpayer all of the remaining shares of Goodlass stock held by it, having a fair market value in 1956 of approximately £1,300,000. (R. 94–95.)

The Tax Court (R. 105–118) and the court of appeals (Pet. 4a–7a) disallowed the currency loss claimed by the taxpayer for 1952. Both courts also included in the taxpayer's income in 1952 the dividends received by Hoyt on the Goodlass stock and in its income for 1951 and 1952 the gains derived by Hoyt from the sale of Goodlass stock to others.

ARGUMENT

1. It is well-settled that a claimed loss from a sale is not deductible unless the sale is genuine, that a transfer of legal title from one taxpayer to another without an accompanying shift of control over the property and relinquishment of the economic benefits

of ownership is not a true sale for tax purposes, and that where the alleged sale is between related parties (here a parent and its wholly owned and controlled subsidiary), the transaction must be specially scrutinized to determine whether it is in fact what, in form, it purports to be. *Higgins* v. *Smith,* 308 U.S. 473; *Crown Cork International Corp.* v. *Commissioner,* 4 T.C. 19, affirmed *per curiam,* 149 F. 2d 968 (C.A. 3d); *Bank of America National Trust & Savings Assn.* v. *Commissioner,* 15 T.C. 544, affirmed *per curiam,* 193 F. 2d 178 (C.A. 9th).

Applying these principles, and considering all relevant circumstances, the courts below correctly concluded that the taxpayer's alleged "sale" of the Goodlass stock to its subsidiary in 1937 was without economic substance and that the 1952 loss which allegedly stemmed from that "sale" was not allowable as a deduction. These conclusions have solid evidentiary support. In view of the terms of the "sale" and the financial condition of the subsidiary, it is evident that the transaction is not one which would have been made at arm's length. The taxpayer admits that the sole purpose of the 1937 transaction was to enable it to claim a tax loss as an offset to gains from other transactions; the subsidiary's income and assets were insufficient to enable it to pay for the stock at the time of the sale or for a long period thereafter; the taxpayer carried the selling price on its books as an open account, without any definite due date and without any interest being charged on the debt; the account was permitted to remain dormant for a long period of time; the eventual "repay-

ment" was made solely to facilitate the parent's financing of another transaction with third parties (*i.e.*, to acquire control of a German company); and the taxpayer continued to receive economic benefits from the Goodlass stock for four more years and ultimately (1956) was restored to possession of all the remaining shares.[2]

The same considerations also support the conclusion that the 1937 transaction lacked substance, not only as a "sale," but even as a contribution to the capital of the subsidiary, and therefore that the taxpayer remained taxable upon the income (both dividends and capital gains) derived from the Goodlass stock. See *Commissioner* v. *Smith*, 136 F. 2d 556 (C.A. 2d); *O'Neill* v. *Commissioner*, 170 F. 2d 596, 597–598 (C.A. 2d). We do not suggest, of course, and the court of appeals did not hold, that whenever property is transferred by a parent to its wholly owned subsidiary, the parent should continue to be treated as the owner because of the control inherent in its ownership of the subsidiary's stock. The holding below was confined to the special facts of this case, where the Goodlass shares were "transferred" solely for the parent's tax purposes, where some of those shares were sold by the subsidiary on cue from the parent and solely to provide it with immediately needed funds, and where the remaining shares were ultimately retransferred to the parent. In these special circumstances, the courts below were justified in concluding that the tax-

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[2] In further support of its conclusion, the court of appeals demonstrated (Pet. 5a) that in reality the taxpayer realized a profit rather than a loss from the transaction.

payer not only retained, but actually exercised, continuing control over the property and thus should be deemed its owner. At any rate, the reasonableness of this judgment presents no question of general importance warranting the intervention of this Court.

2. The taxpayer contends (Pet. 7–12) that the principle of *Higgins* v. *Smith, supra*—which would plainly have barred a loss deduction in 1937—should not be extended to deny a deduction in 1952 based upon a review of the 1937 transaction, and that the decision in this case will enable the government to reopen long-established relationships. We submit, however, that the erroneous allowance of a loss in 1937 does not prevent the Commissioner from re-examining the original transaction in order to consider the propriety of the further loss deduction claimed in 1952.[3] The decision below does not reopen the 1937 transaction insofar as the loss claimed in that year is concerned. It merely takes into account "such facts with relation to the taxes for other years" as were necessary to determine the tax liability for the years in dispute. Section 6214(b) of the Internal Revenue Code of 1954 (26 U.S.C. 1958 ed., Sec. 6214(b)).

3. The taxpayer is hardly in a position to complain (Pet. 12–13) that the decision below may have international double tax consequences. If this be so, those consequences will flow from the form in which the

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[3] See *Automobile Club* v. *Commissioner*, 353 U.S. 180; *Niles Bement Pond Co.* v. *United States*, 281 U.S. 357, 361–362; *Springfield Street Railway Co.* v. *United States*, 312 F. 2d 754, 757–758 (Ct. Cl.). On the facts of this case, the taxpayer's reliance (Pet. 8–12) upon *Rothensies* v. *Electric Battery Co.*, 329 U.S. 296, is misplaced.

taxpayer chose to mold this transaction. In any event, the taxpayer has not shown that it could not have obtained relief under the dividend credit provisions of the taxing statute (*e.g.*, Section 902 of the 1954 Code (26 U.S.C. 1958 ed., Sec. 902)) or its predecessor provisions under the 1939 Code). Further, the question of international double taxation would become moot in 1956 when Hoyt transferred all of its remaining shares of Goodlass stock to the taxpayer.

CONCLUSION

For the reasons set forth above, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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